

## **SOME TRENDS IN THE DEVELOPMENT OF THE SMALL AND MEDIUM BUSINESS IN BELARUS**

### ***Internal and external factors of competitiveness.***

The Belarusian authorities recently made repeated statements about the necessity of the simplification of the conditions of conducting business in the country, about the stimulation of the growth of the private sector, whose share in GDP is among the smallest in the countries of CIS and East Central Europe (20%). The last study of the Research Center of the IPM showed that the main barriers for the development of private small and medium enterprises (SME) were problems of taxation, inspections and fines, big document load, licensing, necessity to receive permissions, and price controls.<sup>1</sup> Hence, the very regulative environment in the country has an anti-entrepreneurial bias. However, Belarusian enterprises adjusted to it, and actively utilize opportunities offered by the growth of real incomes of the population and of the Belarusian economy in general.

Unfavorable external environment makes professional experience and the duration of presence of a company on the market a major factor of success. Because market entry costs are rather high, average age of a Belarusian company exceeds seven years, and number of SMEs in the country had not change in the last five years, staying at around 33 thousand, whereas thousands of companies annually enter and exit the market in the market economies. An average of three SMEs per thousand of population is one of the lowest in the region.

In spite of the repeated statements by the authorities on the simplification of the legislation and the rules of conducting business, the first quarter of 2007 brought no noticeable changes. There were no legislative acts adopted in this period that would have radically changed the rules of the game at the market. The changes were of a generally routine nature, such as indexation of payments and dues, prolongation of certain documents and permissions, etc. In the first quarter of 2007, the government continues to limit the price increased by 0.5 percent per month.<sup>2</sup> If organizations need a greater price and tariff increase, they have to justify it by calculations with description of expenses submitted to the Ministry of Economy. It should be noted that in spite of the resolution, inflation for January-February 2007 reached 2.6 percent, against the yearly forecast of 7-8 percent.

**The most noticeable barriers** for business in the country remain to be external, or uncontrolled by the companies' management, factors, rather than internal, manageable ones. Out of the seventeen barriers offered to the respondents, the most important ones turned out to be the tax system (72% respondents declared it to be important and rather important for the development of a firm), complicated system of tax and other payments (68%), a strong competition on the market (51%), as well as unstable economic situation in the country (48%)<sup>3</sup>. Among other factors, one can also notice high expenditures on raw materials and supplies (36%), shortage of liquid assets for the development of a company (37%), difficulties with obtaining loans (32%). At the same time, such internal factors of enhancing competitiveness and development as the absence of necessary qualification for the development of a firm, absence of qualified employees, fear of making wrong decisions, absence of good ideas on how to conduct business, were appraised by the majority of the respondents as having no importance or having little importance.

75% respondents declared that their company had too many competitors, and, moreover that the competition on their firms' market had strengthened in the past year. Hence, the competition will further increase under the further opening of the market for the foreign (including Russian) companies, its liberalization and simplification of the procedures of conducting business. Accordingly, heads of SMEs

<sup>1</sup> See: <http://research.by/rus/wp/2006/e7b48c713c735dc3.html>

<sup>2</sup> Resolution of the Council of Ministers 30.12.2006. «On some measure to ensure the inflation forecast in 2007».

<sup>3</sup> Study conducted by the Novak laboratory for the IPM research center under the technical support of the Center for International Private Enterprise (CIPE), Washington, DC. Managers of 410 SMEs were polled according to the representative sample. The margin of error is 3%.

will have to share even more attention to the internal factors of competitiveness, such as changes in the marketing system, sales, etc.

Development of the market of professional business education services is an indirect consequence of growing competitiveness. Currently, according to the study, the main competitive advantages of SMES are professional staff (61%), knowledge of the market and ability to foresee the market conjuncture (43%), ability to manufacture competitive production (37%). Three years ago, knowledge of the legislation was marked as a competitive advantage by every fourth respondent, nowadays, by every sixth. Acquaintance with the authorities and connections was marked by 11% of the respondents.

Only 15% of respondents consider it necessary to obtain the MBA degree for themselves and for their subordinates, 34% don't even know what MBA is. Half of the SME employees self-educate, avoiding the services of specialized business education companies, or don't increase their education level at all.

### **Bribes and Corruption**

Almost a half of the Belarusian SMEs give bribes to the authorities from time to time, and a further 23% all the time. Hence, this indicator, more than 70%,<sup>4</sup> stays practically unchanged for several years, in spite of the active fight against corruption in the state, and confirms the conclusions of the Transparency International on the high corruption level in the Belarusian state institutions.<sup>5</sup>

**Table 1. «In your opinion, how often do the managers of private companies have to give bribes in any form to the authorities?»**

	% respondents		
	2002	2005	2007
Sometimes	40.7	57.0	45.4
All the time	39.4	20.3	22.7
No such phenomenon	18.5	18.8	28.8
No answer	1.4	4.0	3.2
Total	100.0	100.0	100.0

Source: IPM research center.

Larger and older companies give more bribes than smaller and younger firms. According to the branches, bribes are more common in trade, catering, construction, which can be explained by a more complicated regulative environment in these businesses. Over a quarter of private companies (27%) offer kickbacks for every third transaction.

**Table 2. «In your opinion, how widespread are kickbacks when obtaining profitable orders in Belarus?»**

	% of respondents		
	2002	2005	2007
At every tenth transaction	11.6	20.5	17.6
At every fifth transaction	18.8	21.3	17.6
At every third transaction	14.3	15.5	13.7
At every second transaction	10.6	8.8	9.5
At every transaction	12.7	1.5	3.7
No such phenomenon	25.9	25.5	33.4
No answer	6.1	7.0	4.6
Total	100.0	100.0	100.0

Source: IPM Research Center.

Once again, the number of kickbacks depends upon the turnover and the size of a company. Thus, 40% of companies employing more than 200 persons use kickbacks at every second transaction, whereas only 12-15% of small companies do. The kickback schemes are most widespread in transport, communications, and construction.

<sup>4</sup> Actual data can be even higher since some respondents do not trust the anonymity of the poll, distrust the interviewers, and, correspondents decline to answer or declare that there is no such phenomenon. Questions on bribes and kickbacks are traditionally met with hostility of the respondents, because the positive answer would imply admission of guilt in illegal activities.

<sup>5</sup> In 2006, Belarus was ranked 151<sup>st</sup> in the corruption perception index, surpassing Russia, Ukraine, and Kazakhstan.

Some positive trend can only be observed in the sphere of shadow turnover. (table 3). ТЕНЕВОЙ Shadow turnover (the turnover unaccounted for in the books) is on the decrease for several years. This, however, only means that the companies are increasingly employing more civilized schemes of optimization and minimization of the taxes, since taxes in Belarus remain to be sky-high. Highly qualified lawyers and accountants can offer various schemes to increase the expenditures and/or decrease the tax base (even employing the butterfly companies). The border between the legal schemes on decreasing taxes and the shadow turnover is often blurred.

**Table 3. «In your opinion, which share of the turnover of private companies is unaccounted for in the books?»**

	% respondents			
	2000	2002	2005	2007
Up to 10%	14.4	17.5	25.0	23.2
10-25%	28.5	19.0	26.5	19.3
26-50%	16.8	3.4	15.0	13.2
51-75%	18.2	3.4	3.8	6.1
More than 75%	-	3.2	1.3	1.5
No answer	15.1	36.0	7.0	3.4
No such phenomenon	6.9	17.5	21.5	33.4
Total	100.0	100.0	100.0	100.0

Source: IPM research center.

Corruption cannot be eradicated when business conditions are overregulated. In this situation, any declarations on expanding the fight against corruption are empty. It is senseless and ineffective to improve the current system defining the business climate in Belarus. It should be totally changed in order to create entirely different rules and institutions defining the rules of the game in the market.

### **Geopolitical Preferences of SME Managers**

Answering the question «How do you appraise the efforts of the government on defending the national interests of Belarus in the energy dispute with Russia?», 21% of the respondents fully approved them, and further 40% rather approved them; 13.2% rather disapproved them, and 3.4% disapproved. 22.4% could not answer the question. Let us remind that the matter of the question is not only the strenuous negotiations on gas and the sale of the 50% of shares of *Beltransgaz* on the New Year eve, but also on the unilateral introduction by Belarus of transit duties for Russian oil which stopped the *Druzhba* pipeline for several days. There is no noticeable differences in the regional breakdown, even though the number of those disapproving the government is a bit higher in the Minsk and Hrodna regions, possibly because those are more politicized regions of the country.

**Table. 4 How do you appraise the efforts of the government on defending the national interests of Belarus in the energy dispute with Russia?**

	Minsk city	Minsk region	Brest region	Hrodna region	Viciebsk region	Homiel region	Mahilou region
Fully approve	26.3	42.1	27.8	20.0	29.4	14.3	26.1
Rather approve than disapprove	50.0	31.6	55.6	48.0	58.8	75.0	56.5
Rather disapprove than approve	15.8	23.7	16.7	28.0	11.8	10.7	17.4
Fully disapprove	7.9	2.6	-	4.0	-	-	-
Total	100.0	100.0	100.0	100.0%	100.0%	100.0%	100.0

Source: IPM study center.

Manages of private SMEs consider the growth of expenditures and some reduction of consumer demand as the most noticeable consequences of the gas price hikes for their businesses.

**Table 5. What may be the consequences for your business of the increase of the prices for the gas imported to Belarus? (no more than three answers):**

	%
Significant increase of expenditures due to the raise of tariffs for energy and gas	42,7
Insignificant increase of expenditures due to the raise of tariffs for energy and gas	33,7
Business will become unprofitable due to new tariffs	9,0
Significant decrease of the consumer demand for production	12,2
Insignificant decrease of the consumer demand for production	15,6
Other	2,4
None	2,7
No answer/Hard to say	3,1

Source: IPM research center

Interesting by enough, while supporting and approving the efforts of the Belarusian leadership in defense of the national interests in the energy dispute with Russia, a large share of the respondents is pessimistic about the expansion of the trade and economic cooperation of two countries, as they fear that it will be more difficult to sell Belarusian goods in Russia and Russian goods in Belarus.

**Table 6. In your opinion, how will the change in relations with Russia affect your business?**

	%
It will be more difficult to sell Belarusian products in Russia	27,1
It will be less difficult to sell Belarusian products in Russia	3,2
It will be less difficult to sell Russian products in Belarus	4,6
It will be more difficult to sell Russian products in Belarus	12,9
No effect	33,2
There are no changes in trade relations between two countries	2,9
Hard to say	16,1
Total	100,0

Source: IPM research center.

Business elites have no doubts about the value of the national independence. 65% believe that Belarus should be the independent state and build partner relations with Russia, 32% - that Belarus and Russia should form the union of independent states, and only 3% that Belarus should join the Russian Federation.

Belarusian entrepreneurs are increasingly supportive of the idea of the European integration. 69% of the respondents believe that Belarus should join the European Union, whereas 31% declare that it should not. There are certain regional differences. (Minsk region – 88% positive, Mahileu – 81%, Hrodna and Viciebsk – 74%, Minsk – 67%).

As the internal European crises (such as adoption of the European constitution, further opening of the markets, integration of new members into “old” Europe”) are settled, Europe can be even more attractive for the private business.

The values of the management of private enterprises are shared by their employees. This is already more than 20% of the working population. Thus, according to another study by the IPM, pro-market and pro-reform attitudes are most widespread among the private sector employees. Whereas only 30% of the total population of Belarus share the values of private property and recognize the necessity of major reforms (privatization, price liberalization, opening of the banking sector, privatization of infrastructure, etc.) the same number among the private sector employees is 60%<sup>6</sup>.

Pro-European and pro-market attitudes will be on the rise as the private sector expands. The Presidential Administration, the parliament, the foreign ministry can accelerate or impede this process. But they cannot stop it.

<sup>6</sup> See: “Public Attitudes of the Population of Belarus to Market Reforms,” <http://research.by/pdf/WP2006r06.pdf> and “Perception of the Values of Market Economy by the Population of Belarus,” <http://research.by/pdf/WP2006r07.pdf>